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Supreme Court of the United States.

OCTOBER TERM, 1909.

NO. 416.

THE DELAWARE AND HUDSON COMPANY,
Defendant-Appellant,
against
ALBANY AND SUSQUEHANNA RAIL ROAD COMPANY,
Defendant-Appellee;
ÆTNA INSURANCE COMPANY ET AL.,
Complainants-Appellees.

MOTIONS TO ADVANCE.

GEORGE WELWOOD MURRAY,
E. PARMALEE PRENTICE,
CHARLES P. HOWLAND,
Of Counsel for Aetna Insurance Company and other Complainants-Appellees.

C. G. Burgoyne, 72 to 78 Spring Street, New York.

Supreme Court of the United States,

OCTOBER TERM, 1908.

No. 416.

THE DELAWARE AND HUDSON COMPANY,
DEFENDANT-APPELLANT,

AGAINST

ALBANY AND SUSQUEHANNA RAIL ROAD COMPANY,
DEFENDANT-APPELLEE.

ÆTNA INSURANCE COMPANY ET AL.,
COMPLAINANTS-APPELLEES.

I.

And now come the above-named Ætna Insurance Company and others, complainants in the Circuit Court, appellees in the Circuit Court of Appeals for the Second Circuit, and move the Court that this cause be advanced on the docket and set down for hearing upon a day certain.

STATEMENT OF FACTS.

Complainants are stockholders in the Albany and Susquehanna Rail Road Company, some being citizens of the State of Rhode Island and all others citizens of the State of Connecticut.

The defendants are the Albany and Susquehanna Rail Road Company and The Delaware and Hudson Company, both being corporations of the State of New York.

In 1871 the Susquehanna Company leased all its property in perpetuity to the Delaware Company (Rec., pp. 8, 61), the principal part of the rent to be paid as guaranteed dividends directly to stockholders in the lessor corporation, the balance to go to the Susquehanna Company or for its account; the lessee's covenants to make all these payments being contained both in the lease and also by direct undertaking with each stockholder endorsed upon his certificate (Rec., pp. 8–9, 76). All the stock in the Susquehanna Company was so endorsed and guaranteed by the Delaware Company, including the stock held by complainants. The Delaware Company having failed to pay the rent due under the lease and guarantees, the present suit was instituted on June 12, 1906, in behalf of the complainants and all others similarly situated for an accounting of all rental payments due under the lease and the respective guarantees.

The defendant corporations Albany and Susquehanna Rail Road Company and Delaware and Hudson Company, demurred to complainants' bill (Rec., pp. 45, 81). The demurrers were general, raising the entire merits of the case, but were also specific asserting that complainants had failed to comply with Equity Rule 94 and were therefore unable to maintain the action. The Delaware and Hudson Company repeated these defenses subsequently by answer and also set up other defenses, including laches and the statute of limitations.

In the Circuit Court jurisdiction was sustained, evidence was introduced and on January 24, 1908, decree against the Delaware Company was entered for the sum of $1,107,923.24, arrears of rent, with interest, accruing since June 12, 1886. From this decree the defendant The Delaware and Hudson Company appealed to the United States Circuit Court of Appeals for the Second Circuit where this case was argued in April, 1908. On May 22, 1908, the Circuit Court of Appeals certified to this Court the questions here presented for decision.

> FIRST: "Does the fact that before institution of this suit complainants made no demand for relief upon the Board of Directors of the Susquehanna Company prevent them from maintaining this bill?"

SECOND: "Does the fact that before institution of this suit complainants made no effort to obtain relief at a stockholders' meeting prevent them from maintaining this bill?"

Awaiting the instructions of this Court, the said Circuit Court of Appeals now retains the cause under advisement until the answer to these questions shall be received.

These interrogatories involve:

A. The construction of Rule 94, in cases where the corporation whose rights it is sought to assert, is in the hostile control of the corporation against which the demand is made; and

B. The question whether Rule 94 applies to holders of guaranteed stock.

A. DELAWARE CONTROL OF THE SUSQUEHANNA COMPANY.

When this suit was instituted, and long prior thereto, the Board of Directors of the Albany and Susquehanna Rail Road Company was composed entirely of directors, officers and representatives of the Delaware and Hudson Company. This management of the Susquehanna Company the Circuit Court of Appeals in its certificate in this case termed "*the administration of the Delaware Company*" (Certificate of Circuit Court of Appeals, Rec., p. 3). The present suit was instituted to review the conduct of this Board of Directors. In their relation to the Delaware Company the persons who composed the Board of Directors of the Albany and Susquehanna Company when this bill was filed, were charged with the protection of the interests of the Delaware Company and the defense of all litigation instituted against that company. In their relation to the Susquehanna Company the conduct of the persons who composed the Board of Directors of that Company at the time this bill was filed, furnishes the subject matter of the litigation. The Circuit Court of Appeals states in its certificate that "none of the directors or officers of the Delaware Company ever, before or after the bringing of this suit, treated the claim therein set forth otherwise than as one of doubtful validity the payment of which was to be resisted" (Rec., p. 2). For at least six months before this suit was begun the Susquehanna directors had known the claim which their corporation held against the Delaware Company, for "from and after December 1905" a Committee of Susquehanna stockholders "had been opposing the administration of the Delaware Company upon the questions involved in this bill" (Certificate of Circuit Court of Appeals, Rec., p. 3). For many years the Delaware ad-

ministration had failed to assert Susquehanna rights against the Delaware Company ; for six months during which this neglect was the subject of agitation among stockholders the directors insisted upon their previous course ; after the bill was filed the Susquehanna corporation under their control joined with the Delaware Company in resisting the suit (Certificate ; Rec., p. 3). Complainants were unwilling that this litigation against the Delaware Company should be controlled by representatives of the corporation against whom the claim was asserted and who moreover were personally interested in seeing it defeated, and for this reason complainants did not before filing the present bill make any demand upon the Susquehanna directors for relief. The bill of complaint, which is verified by oath, after making very specific charges that the directors were and had been acting in collusion with the Delaware Company to protect it against the liability asserted in this case alleged that no demand for relief had been made by complainants upon directors " for the reason that such demand, under the facts and circumstances set forth, would be idle and nugatory, and that this suit is not a collusive one to confer jurisdiction upon the Circuit Court of the United States in respect to a matter of which it would not otherwise have cognizance " (Rec., pp. 21–22).

The charter of the Albany and Susquehanna Rail Road Company gives the entire management of corporate affairs to the Board of Directors (Rec., p. 2). Under this charter stockholders cannot by any action, vote or resolution authorize or compel the institution of any suit or proceeding in law or equity, nor were a suit instituted, could they control, manage or affect the same. The function of stockholders in this corporation is fully performed by the annual election of directors. No demand for relief was made by complainants upon stockholders before filing this bill for the reason that the stockholders could afford no relief. The most stockholders could do would be to refer demandants to a Board of Directors, in whom entire authority and discretion is vested.

Furthermore, the Susquehanna Company has been, since the lease was made, a subsidiary corporation of the Delaware and Hudson Company, entirely controlled by the main corporation, which maintained direct relations with Susquehanna stockholders and paid to them the income derived from their stockholdings. When complainants filed their bill the Delaware and Hudson Company controlled the stock vote of the Albany and Susquehanna Rail Road Company.

B. DOES RULE 94 PREVENT ACTIONS BY HOLDERS OF GUARANTEED STOCK?

The Certificate of the Circuit Court of Appeals refers to the pleadings for a "more detailed statement of the cause of action" (Rec., p. 1, folio 2). From the bill it appears that complainants assert a two-fold ground of jurisdiction, setting up not only their rights—under the circumstances of the case—to sue in behalf of the corporation, but also expressly founding their bill upon their direct relations with both defendant corporations under the guarantee (Bill of Complaint; Rec., pp. 4, 5, 6, 9, 17), claiming to sue in their own right upon the corporate contract to which they were parties. In this aspect of the case, the question whether complainants can maintain this action is, in another form, the question whether guaranteed stocks differ in any respect from stocks which have no guarantee, for if the guarantee will support no action it is no security. It can be shown, when the case is presented for argument, that unless the action now at bar can be maintained the Delaware Company's guaranty will support no action whatever.

> "The subject-matter here is mainly the lease itself and the collection of the rents therein provided for. In these the plaintiffs have a joint interest." * * * "It would seem that it is only through an equitable action that the proper relief can be obtained, and but for this plaintiffs would be without means of redress."
>
> *Barr vs. Railroad Company, 96 N. Y., 444, 450, 452.*

Guaranteed stockholders cannot maintain separate actions at law for many reasons. Among other things separate actions would involve preferences and unequal division of corporate income among stockholders. The rent arising from the lease may be subject to off-set, as in the present case where the off-sets claimed by the tenant exceed the sum for which judgment has been rendered. The tenant is entitled to assert whatever off-set it may have as against the entire rent arising under the lease. The whole matter therefore must be litigated in one proceeding. It is of first importance to the complainants, therefore, that they maintain the security of their guaranty and that the bill be sustained upon the strength of their direct relations with both defendant corporations.

Upon the facts thus recited complainants show to the Court in support of the foregoing motion the following:

SPECIAL AND PECULIAR REASONS FOR ADVANCEMENT OF THIS CASE.

FIRST. Very large investments of fiduciary and trust funds have been and are continually made in guaranteed stocks relying upon the security of the guaranty. Unless the guaranty is a valid, legal and binding obligation, capable of supporting a direct action by the holder thereof, all such investments, so far as concerns the security of the guaranty, are questionable and of uncertain value.

Until brought into doubt by the certificate in this case guaranteed stocks have commanded public confidence because considered to afford greater security than that afforded by stocks bearing no guaranty and for this reason many states have authorized savings banks and trustees to invest in these stocks. This case, and the questions involved, are widely known in the security markets of this country, and it is of great commercial importance to all persons, corporations and trustees interested in guaranteed stock that the doubt thus raised as to the value of guaranteed stocks be determined at an early day.

SECOND. The questions as to the proper construction and meaning of Equity Rule 94 presented in this case are frequently involved in litigation in lower courts of the United States, and it is important that these questions be determined at as early a day as possible.

THIRD. The questions arising in this case, including the questions above certified and the merits of the case, have been fully argued and are now under advisement in the Circuit Court of Appeals, where the determination of the case awaits the disposition of the preliminary jurisdictional questions certified to this Court.

Rule 26 provides that cases once adjudicated by this Court upon the merits and again brought up may be advanced by leave of the Court on motion of either party, but this case being now before the Court upon preliminary questions jurisdictional in nature, and not upon the merits, would not be entitled under the foregoing rule to advancement were it brought here after final determination by the Circuit Court of Appeals.

Unless the case be now advanced the separation of questions by the certificate of the Circuit Court of Appeals makes double delays

for this litigation—the delay of now awaiting its place on the call of the docket of this Court being about a year and a half, to which would be added delays of re-argument in the Circuit Court of Appeals and a further delay in awaiting again the call of this Court should the case come here on the merits.

The prompt and orderly progress of this litigation in the Circuit Court of Appeals and in this Court require that preliminary questions should receive the attention of this Court at as early a date as possible consistent with its practice and convenience and its views of the public interest.

FOURTH. The stock of the Albany and Susquehanna Rail Road Company is very widely distributed and held in small amounts by many women, minor children and trustees. These small holders are greatly prejudiced by delay in the progress of this litigation. Four-fifths of the number of stockholders in the Susquehanna corporation hold fifty shares in said corporation or less (Rec., p. 3).

II.

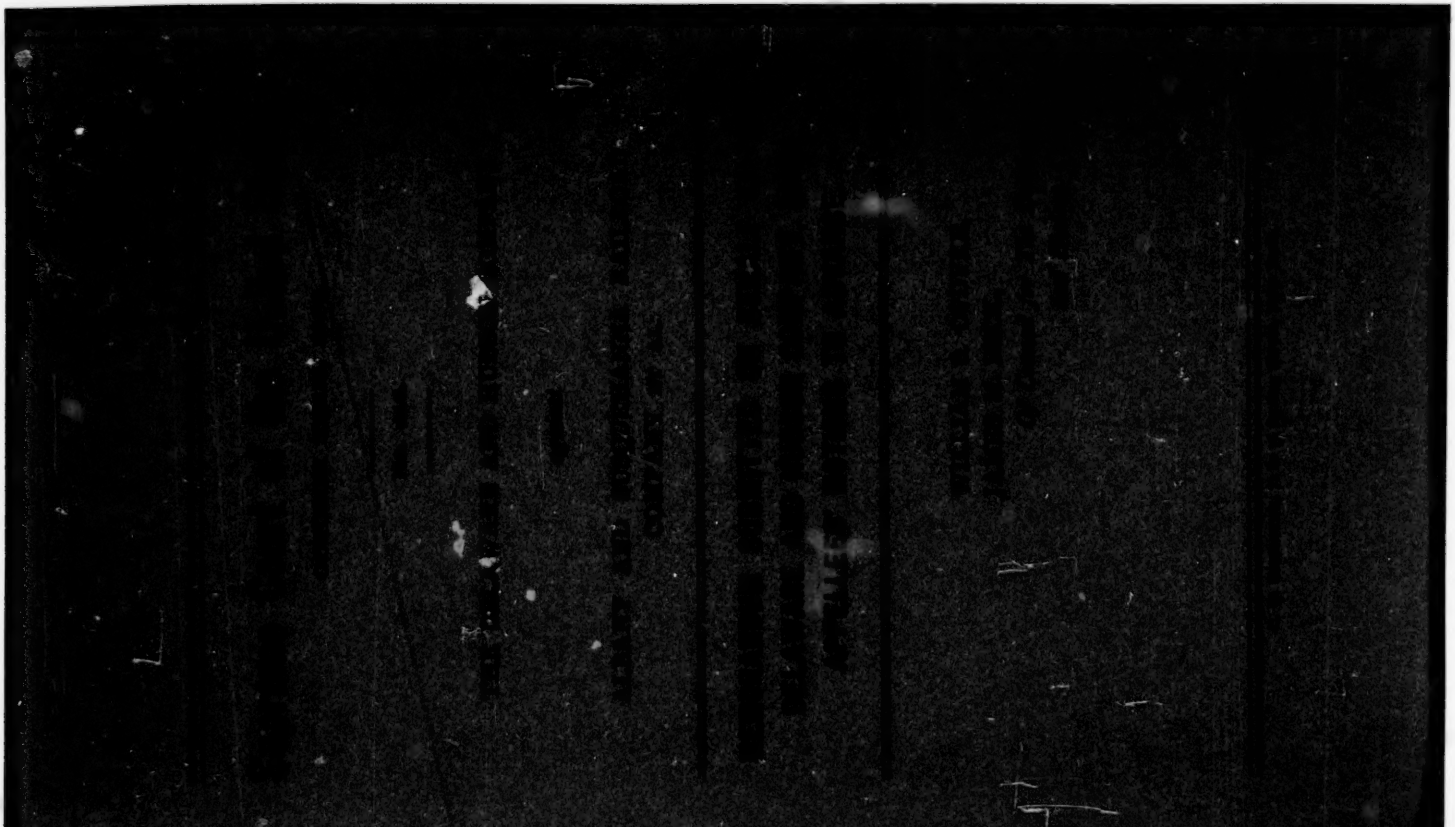
Should the foregoing motion be denied, the appellees move that this, the above-entitled cause, be advanced as under Rule 32, and taken upon briefs or heard as the Court may direct, in accordance with the provisions of Rule 6 concerning motions to dismiss writs of error and appeals.

As grounds of such motion, the said Complainants-Appellees show to the Court:

Causes brought to this Court by writs of error and appeal from the Circuit Court for decision, and in which jurisdictional questions alone are presented for determination, are, under said Rule 32, advanced for hearing. The purpose of said rule appears to be to facilitate the speedy administration of justice in the lower courts, and to this end to secure the prompt disposition of preliminary questions. In the present case the questions certified are prelim-

inary and jurisdictional questions (Chicago vs. Mills, 204 U. S., 321); and the case in which they arise is now under advisement awaiting the action of this Court. Had the case come before this Court upon appeal or writ of error, it would have fallen within said Rule 32, and being presented by certificate from the Circuit Court of Appeals, the case falls equally within the purpose of the rule.

GEORGE WELWOOD MURRAY,
E. PARMALEE PRENTICE,
CHARLES P. HOWLAND,
Of Counsel for Ætna Insurance Company and other Complainants-Appellees.



Supreme Court of the United States,

OCTOBER TERM, 1908.

No. 416.

THE DELAWARE AND HUDSON COMPANY

AGAINST

ALBANY AND SUSQUEHANNA RAILROAD COMPANY, ET AL.

MEMORANDUM

in behalf of the Delaware and Hudson Company, submitted upon appellees' motions to advance.

The Delaware and Hudson Company, the appellant below, will be satisfied to argue this cause whenever it is the pleasure of the Court to assign the same for argument. We, its counsel, feel constrained, however, to submit to the Court certain reasons why the present case has no just claim for advancement over other cases upon the calendar, and to this course we are somewhat forced by the action of counsel for the appellees below, in attempting in a motion to advance the cause to anticipate an argument upon the merits by statements of fact and conclusions of law which are not only not

pertinent to a motion to advance, but in some instances are not justified by the record.

This motion to advance this cause, to the prejudice of other cases upon the calendar, seems peculiarly destitute of merit. This Court has said in *Carter vs. Greenhow, 109 U. S., 64*, that even though "the questions involved may be of public importance," yet such fact "does not necessarily entitle the parties to a hearing in preference to others." Under the rules of this Court, and its uniform practice, the advancement of a case depends not merely upon questions "of general public interest," but it must further clearly appear that in some especial way the postponement of a decision will involve some peculiar and exceptional hardship upon a litigant. Even where the United States moves to advance, the facts must clearly disclose that "the Government will be embarrassed in the administration of its affairs by delay" *(United States vs. Norton, 91 U. S., 558)*.

The ultimate question in this case is not of general importance. It affects only the construction of a peculiar contract, and its decision cannot affect any one except the parties to this contract. As a precedent, the case on its merits is without any public interest or importance.

The questions raised by the certification do not involve the *jurisdiction* of the lower Court in the true sense of the word *(Venner vs. Northwestern Co., 209 U. S., 24)*, but involve only the right of the complainants under the general principles of equity jurisprudence and especially under Rule 94, to commence a suit in behalf of a corporation, of which they were stockholders. Whether these complainants have established such right is a matter of interest to them and to the corporation, but as the alleged right rests upon facts that are peculiar to this case, it cannot be regarded as of any general importance.

The complainants therefore not only have no higher claim to a preferential hearing than any other litigant in this Court, but as their present claim is to enforce

an alleged right, *which they aver first accrued in 1880* (Record, p. 18), their gross and unexcused laches of twenty-six years gives them even less claim for a preference over other and more diligent litigants.

Of the several reasons urged by the appellees in support of their motions to advance this cause, we submit that no one is tenable.

It is true that this case comes to this Court upon a Certificate of the Circuit Court of Appeals (Second Circuit), under the provisions of Section 6 of the Act of March 31, 1891, and that, therefore, the final disposition of the case in the Court of Appeals is held in abeyance until the instructions of this Court are delivered. But we know of no rule or practice of this Court, which advances all causes so certified, for that reason alone.

It is possibly also correct to say that the Court of Appeals desires the instructions of this Court upon the questions certified, not only for the proper disposition of this case, but for application in other cases which may be commenced in the future. But that would be so in all certified cases.

It is also true that a number of the parties to this cause are *corporations*, and that, therefore, their individual stockholders constitute a somewhat numerous body of individuals who are interested in the final outcome of this case. But this, we submit, is no sufficient reason for granting this cause a preference upon the calendar of this Court. In this connection, it is proper to point out that the "many women, minor "children and trustees" who are stockholders of the Susquehanna Company, are, by the admissions of the Bill of Complaint, presently receiving nine per cent. annual dividends from the Delaware Company (Rec., pp. 12, 13, 17, 18).

The only other reasons urged by the appellees in support of their motions, are, *first*, that a broad question of *the security of guaranteed dividends* is involved

in this case; and, *second*, that a question of the *jurisdiction* of the Circuit Court is also involved. We shall endeavor to show that neither of these questions is in the slightest way presented upon this record.

The complainants in this suit are thirteen stockholders of the Susquehanna Company. Their bill was attacked by the Delaware Company as multifarious, both by demurrer (Record, pp. 45, 46) and by answer (Record, p. 60), because it united a principal claim *in behalf of complainants' corporation* against the Delaware Company, with a minor claim in behalf of the *stockholders individually* against the Delaware Company—this latter claim being founded upon an alleged breach of the terms of the guaranties endorsed upon the complainants' individual certificates of stock of the Susquehanna Company. This double character of the bill can be readily seen by reading the double prayer for relief at the end of the bill (Record, p. 22). *The Circuit Court, however, granted no pecuniary relief whatsoever to the complainants individually*, its decree, as described in the Certificate, being simply and solely that the *Delaware Company pay to the Susquehanna Company the amount of $1,107,923.24* (Record, p. 1). The consequence of this action by the Circuit Court was not only to avoid the objection of multifariousness, *but also to eliminate all question of the right of guaranteed stockholders to sue in equity, some in behalf of all others.* The complainants have not appealed from the decree of the Circuit Court, which gave them nothing, and we do not see how they can be now heard to defend a decree in favor of their corporation, in a suit instituted by them as stockholders, on the ground that they also had individual claims upon their guaranties. Surely the bill must be read in the light of the decree, and if so read, it will be found that the only parts of the bill which related to guaranteed dividends were eliminated by the Circuit Court. Moreover, a conclusive answer to the appellees' claim that an important question of the "security of guaranteed dividends" is presented in this case, is the fact that

neither one of the two questions certified to this Court refers to any such subject.

The appellees urge finally that a *jurisdictional question* is involved in this case, which entitles them to an immediate hearing. It is true that the Circuit Court of Appeals, in its Certificate, speaks of the question of "whether the bill could be maintained under the 94th Equity Rule" as "jurisdictional in character," citing *Chicago vs. Mills, 204 U. S., 321*, and *Doctor vs. Harrington, 196 U. S., 579* (Record, p. 1). It has been, however, very recently settled by this Court, in *Venner vs. Northwestern Company, 209 U. S., 24*, that noncompliance with Rule 94, does not affect the jurisdiction of the Circuit Court, but relates only to the question whether a sufficient equitable cause of action has been shown.

It needs no argument to show that Rule 32, which the complainants also invoke, is without application to a case of this character. That Rule, by its very terms, refers to cases brought to this Court under Section 5 of the Act of March 3, 1891; whereas this case comes to this Court, not upon any question of fundamental jurisdiction, but on a request for instructions under Section 6 of the said Act (*Carter vs. Greenhow, 109 U. S., 64*).

A number of statements contained in the appellees' motion papers are wholly without support in the record, as for instance, that the Susquehanna Company demurred to the bill "upon the merits"; that at the time of the commencement of this suit, the Delaware Company "controlled the stock-vote" of the Susquehanna Company; and that at the same time, the board of the Susquehanna Company was composed "entirely of directors, officers and representatives" of the Delaware Company. But these are matters to be postponed until the argument of this case, at which time

we believe it will abundantly appear that the real question before this Court, is merely whether the complainants did not bring this particular "stockholders' suit" in the Circuit Court, without stopping to read Equity Rule 94—a question, we submit, which is not of overwhelming importance in the administration of justice in the United States.

Respectfully submitted,

WILLIAM S. OPDYKE,
JAMES M. BECK,
Of Counsel for The Delaware and Hudson Company.

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No. 416.

Supreme Court of the United States.

OCTOBER TERM, 1908.

THE DELAWARE AND HUDSON COMPANY,
Appellant,

against

THE ALBANY AND SUSQUEHANNA RAILROAD COMPANY ET AL.,
Appellees.

BRIEF ON BEHALF OF THE DELAWARE AND HUDSON COMPANY, APPELLANT.

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In the Supreme Court of the United States.

THE DELAWARE AND HUDSON COMPANY,
Appellant,

AGAINST

THE ALBANY AND SUSQUEHANNA RAILROAD COMPANY, THE AETNA INSURANCE COMPANY and others,
Appellees.

October Term, 1908.
No. 416.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF ON BEHALF OF THE DELAWARE AND HUDSON COMPANY, APPELLANT.

Statement.

This suit was brought in the United States Circuit Court, Southern District of New York, against the Albany and Susquehanna Company (hereinafter called the Susquehanna Company) and The Delaware and Hudson Company (hereinafter called the Delaware Company), both citizens of the State of New York, by the Aetna Insurance Company and twelve other stockholders of the Susquehanna Company, all of such com-

plainants being citizens of other States than the State of New York (Record, p. 1).

There was no ground for federal jurisdiction other than this diversity of citizenship.

"The bill was brought to obtain an accounting for various sums of money, which it was alleged became due at intervals during a series of years from the Delaware Company *to the Susquehanna Company* as rental or in the nature of rental under a lease made in 1870" (Rec., p. 1). It appears, therefore, that the suit was brought by the complainants as stockholders of the Susquehanna Company in a derivative capacity on behalf of the Susquehanna Company.

The trial of the cause resulted in a decree of the Circuit Court that the Delaware Company should pay to the Susquehanna Company the amount of $1,107,923.24 (Rec., p. 1).

Upon appeal taken by the Delaware Company from this decree to the United States Circuit Court of Appeals, the cause was fully argued and submitted upon briefs (Rec., p. 1).

It having appeared that there was involved the question whether the complainants' bill could be maintained under the 94th Equity Rule, the Circuit Court of Appeals has certified that question as a preliminary one to this Court, for instructions as to whether upon the facts stated in the Certificate the complainants can maintain their bill (Rec., pp. 1–3).

The specific questions certified are as follows:

> FIRST. "*Does the fact that before institution of this suit complainants made no demand for relief upon the Board of Directors of the Susquehanna Company prevent them from maintaining this bill?*"
>
> SECOND. "*Does the fact that before institution of this suit complainants made no effort to obtain relief at a stockholders' meeting prevent them from maintaining this bill?*"

The entire Certificate of the Circuit Court of Appeals is annexed as an appendix to this brief for convenient reference.

It includes the "Statement of Facts" certified by the Court of Appeals, upon which the said questions of law arose, and this statement necessarily embraces all the *facts* which can be referred to in the argument herein.

The Court of Appeals appended to this Certificate as "Exhibit A" copies of all the pleadings in the cause in the Circuit Court (Rec., pp. 4-81), stating that the same "*may be referred to for a more detailed statement of the cause of action.*"

The Cause of Action.

The suit is for the recovery of rentals alleged to be due by the Delaware Company to the Susquehanna Company under a lease made in 1870.

The lessor, the Susquehanna Company, was organized under Chapter 140 of the N. Y. Laws of 1850, passed April 2, 1850 (Rec., pp. 1, 6). Section 5 of this statute provided *inter alia :*

> "SEC. 5. There shall be a board of thirteen directors of every corporation formed under this Act to manage its affairs. Said directors shall be chosen annually by a majority of the stockholders voting at such election * * *. At every election of directors the books and papers of such company shall be exhibited to the meeting, provided a majority of the stockholders shall require it."

Not only was there this statutory requirement of annual elections of directors by the stockholders of the Susquehanna Company, but the latter expressly covenanted in the lease to maintain its corporate organization (Rec., p. 30), and annual meetings of the shareholders for the election of directors were in fact held continuously since 1870 (Rec., pp. 19, 20).

The lease in question was made by the Susquehanna Company to the Delaware Company on February 24, 1870 (Rec.,

pp. 26-34), but was modified by a "Supplemental Contract" made March 7, 1876 (Rec., pp. 35–39).

The Delaware Company, under the provisions of this lease, so modified, agreed to pay as rental an amount equivalent to the interest charges upon the bonds of the Susquehanna Company and fixed dividends upon its stock, and as a matter of convenience both the interest charges and fixed dividends were paid by the Delaware Company directly to the bondholders and stockholders respectively. As to one of the mortgage loans of the Susquehanna Company, there was a special provision for a sinking fund, the annual instalment of which the Delaware Company further agreed to pay. It is undisputed that the Delaware Company did pay the fixed dividends, and the annual interest and sinking fund requirements. Originally the interest on the bonded indebtedness was at the rate of seven per cent., but this was subsequently reduced by successive refundings, first to six per cent. and later to three and a half per cent., and the main question involved and "cause of action" in this suit, was whether the savings thus effected by such refundings were or were not payable by the Delaware Company to the Susquehanna Company.

The complainants contended in this suit, on behalf of the Susquehanna Company, that the savings of interest so arising belonged, under the terms of the Lease and Supplemental Contract, to the Susquehanna Company, in addition to the fixed dividends paid to its stockholders. The Delaware Company denied that this contention was justified by the provisions of these two contracts as properly construed. The contention of the complainants was, however, sustained by the decision of the Circuit Court. The Circuit Court of Appeals has not passed upon this question of construction.

The complainants also included in their bill a special claim, made solely in their own behalf as individual stockholders and not in a derivative capacity. This claim was based upon

a direct guaranty made by the Delaware Company to the stockholders of the Susquehanna Company. As this claim was not recognized by the Circuit Court, which by its decree treated the suit as wholly and exclusively a suit by the stockholders on behalf of the Susquehanna Company, and as no question is certified to this Court with respect to the right of the complainants themselves to maintain a claim on the said guaranty, the right of the complainants by this suit to maintain this special claim is not now before this Court, and the facts with reference to it need not therefore be more fully stated.

The following quotation from the commencement of the Certificate at once describes the decree of the Circuit Court, and limits the subject matter of the instructions prayed for by the Circuit Court of Appeals:

> "This cause comes here upon appeal from a final **decree** of the Circuit Court, Southern District of New York, **which directs that the defendant Delaware and Hudson Company** (hereinafter called the Delaware Co.) **pay to the defendant the Albany and Susquehanna Railroad Company** (hereinafter called the Susquehanna Co.) **the amount of $1,107,923.24.**
>
> "The case was fully argued and submitted on briefs. **It thereupon developed that there was a question presented whether the bill could be maintained under the 94th Equity Rule.** That question is a preliminary one, it has been held to be jurisdictional in character (City of Chicago vs. Mills, 204 U. S., 321; Doctor vs. Harrington, 196 U. S., 579), **and this court desires the instruction of the Supreme Court for its proper decision."**

The aforesaid incidental claim of the complaining stockholders, as individuals, upon a direct guaranty, for a small portion of the entire sum in controversy, arising under special circumstances and sued for in a different capacity than the

asserted right in behalf of the corporation, should, therefore, be eliminated from the consideration of this case, for four controlling reasons:

1. The principal claim of complainants, as alleged in the bill, was explicitly based upon a claim of right to sue in a derivative capacity for the Susquehanna Company to recover a sum due to it and not to such stockholders as individuals.

2. The Circuit Court maintained the suit on this theory, and the only decree which it entered directed the payment of a sum to the Susquehanna Company and not to the complainants.

3. The complainants acquiesced in this treatment of the case by taking no appeal from the failure of the Circuit Court to recognize their claim for a lesser sum on the direct guaranty.

4. The Certificate of the Circuit Court of Appeals relates wholly to the right to maintain a stockholders' bill and asks for no instructions as to the lesser right under the direct guaranty.

For these reasons this Court should not confuse a cause of action as to which a decree was entered, with a separate cause of action as to which a decree was denied. The complainants cannot justify their unwarranted assumption of corporate authority in the commencement of this suit by joining with it a separate claim to which on their theory the corporation was not a necessary party. We are confident that this Court will not sustain so easy a method of nullifying the 94th Rule and the principles of equity, upon which it is based.

From this brief statement of the "cause of action," two things are apparent and will, we trust, be borne in mind by the Court in its consideration of the "statement of facts" under which the questions are certified to this Court:

1. The alleged claim which the stockholders of the Susquehanna Company sought by this suit to assert against the

Delaware Company was merely for a debt alleged to be due to the Susquehanna Company for unpaid rentals.

2. Its judicial determination required only the true construction of certain contracts, the execution of which was not disputed.

The ultimate questions which the Certificate herein presents may be briefly stated as follows:

(1) May certain stockholders institute a suit for the benefit of a corporation to enforce its claim against a third party, without first attempting to secure action on the part of the directors and without specifying in their bill and showing by their proofs "the causes of their failure to obtain such action"?

(2) Is the failure to make such attempt excused by the fact that a majority of the Board of Directors of the Susquehanna Company "consisted of persons who were also officers, directors or employees of the Delaware Company?"

(3) Is the added failure of such stockholders to make "any efforts to secure 'such action on the part of the shareholders'" before commencing their suit in behalf of the corporation excused, when neither the bill sets forth nor the proofs show "the causes of their failure to obtain such action", and where it further appears that within four months after the institution of the bill the complaining stockholders at the annual election of the Susquehanna Company secured the co-operation of a majority of such stockholders in the election of a new Board of Directors wholly favorable to the assertion of the claim?

These questions must be decided upon the certificate of facts set forth by the Circuit Court of Appeals. It must be assumed for the purposes of this argument that the certificate fully summarizes the allegations of the bill and the results of the evidence,

so far as the jurisdictional question is concerned. The evidence is not before this Court. The bill and answers are only before the Court to show the "cause of action."

It will thus serve no useful purpose to set forth at length the allegations of the bill which attempt to justify the right of the complainants to sue in a derivative capacity, for the "statement of facts," as certified by the Court of Appeals, expressly finds that :

> *"The bill does not 'set forth with particularity' the efforts of the plaintiffs to secure such action as they desire on the part of the managing directors or trustees." "Nor does the bill set forth any efforts to secure 'such action on the part of the shareholders.'"*

It is equally unimportant to discuss the allegations of the bill, which sought to excuse the failure to secure action on the part of the directors and other shareholders, for the Certificate expressly finds :

> *"Nor did the bill set forth or the proofs show 'the causes of their failure to obtain such action' otherwise than as hereinafter disclosed."*

The subsequent statements in the Certificate thus referred to show merely that a majority of the board of directors of the Susquehanna Company were and had been for some time officers, directors or employees of the Delaware Company, and that six of the thirteen directors did not own or hold in their own right any shares in the Susquehanna Company ; that at the time of the filing of the bill, the Delaware Company owned or controlled 8,840 shares of the 35,000 shares of stock, while the complainants and their associates, who, for six months "had been opposing the administration of the Delaware Company *upon the questions involved in this bill,*" controlled 8,000 shares ; and that as a result of the contest at the annual election, which was held about four months after the filing of the bill, the complainants and their associates polled 15,501 ballots to the 15,441 ballots polled by the administration ticket.

The Circuit Court of Appeals also annexed to their Certificate as "Exhibit B" the original demurrer in the cause filed on behalf of the Susquehanna Company and afterwards withdrawn (Record, pp. 81, 82).

The complainants, in their memorandum upon the motion to advance this cause, claimed that this demurrer went to the "entire merits of the case." An examination of this demurrer (Record, p. 81) shows, however, that the demurrer did not go to the merits of any claim of the Susquehanna Company against the Delaware Company, but only to the question whether the complainants as stockholders were entitled to any relief against the Susquehanna Company, or were entitled to maintain their bill as stockholders on behalf of the Susquehanna Company.

While we believe that the Circuit Court of Appeals would have been justified in adding to this "statement of facts" a number of other considerations tending to deny to the complainants any right to sue in behalf of their corporation, yet we feel constrained to limit our discussion of the questions certified to the "statement of facts" of the Court of Appeals, and therefore insist that counsel for the appellees shall also keep within the facts as certified.

Equity Rule 94.

While the certified questions must be answered by an application of the general principles of equity, yet obviously both questions have especial reference to the application of equity rule 94, regulating procedure in stockholders' suits. That rule is as follows:

> "94. Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded upon rights which may properly be asserted by the corporation, must be verified by oath, and must con-

> tain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a Court of the United States jurisdiction of a case of which it would not otherwise have cognizance. *It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action.*"

The question involved in this certification is whether complainants complied with the italicized portion of this rule. The question is not only one of pleading, but is essentially one of proof. What must be pleaded, obviously must be proved.

It will be seen that the Certificate closely follows the language of the rule. Its essential averment is:

> "The bill does not set forth with particularity the efforts of the plaintiffs to secure such action as they desire on the part of the managing Directors or Trustees, nor did the proofs show any such efforts, nor does the bill set forth any efforts to secure such action on the part of the shareholders, nor did the proofs show any such efforts, nor did the bill set forth or the proofs show the causes of their failure to obtain such action otherwise than is hereinafter disclosed."

And, as previously stated, the only two facts thus disclosed to excuse the failure of the complainants to obtain action either of the directors or of the other shareholders of the corporation are the facts:

1. That a majority of the directors of the Susquehanna Company were officers, directors or employees of the Delaware Company, and that six of them did not own any shares of Susquehanna stock, except those nominally held to qualify them as directors.

2. That neither the Delaware Company nor the complaining stockholders at the time the bill was filed, owned or controlled a majority of the Susquehanna Company's stock, but that at the next annual election, in a contest involving the precise claim in this suit, the complaining stockholders and their associates proved that it was possible for them to secure a majority of the stock vote of the Susquehanna Company and elect a managing body in sympathy with their views.

ARGUMENT.

We contend that the statement of facts set forth in the Certificate wholly fails, under the uniform rulings of this Court,—

(1) to excuse the complainants from omitting to make preliminary application to the managing body of the corporation to institute such suit to assert a claim which, if it existed at all, was the property of the Susquehanna Company as a corporate entity and not of the complaining stockholders, and

(2) that even if the failure thus to apply to the managing body were excused by the fact that a majority of such managing body were also officers, employees or directors of the Delaware Company, the Certificate wholly fails to disclose any facts which, under the rulings of this Court, would excuse the added failure of the complainants to apply to the stockholders of the Susquehanna Company for action before they usurped its corporate authority and asserted a right due to such corporate entity.

If *either* of these questions is decided in favor of the appellant, the present suit cannot be maintained, and they will therefore be separately discussed under Points Second and Third. The general principles of equity, which govern both questions and of which rule 94 is but an expression and method of application, will be briefly discussed by us under our First Point.

FIRST POINT.

Before a shareholder "is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the Court that he has exhausted all the means within his reach to obtain within the corporation itself the redress of his grievances or action in conformity to his wishes. He must make an earnest, not a simulated, effort with the managing body of the corporation to induce remedial action on their part, and this must be made apparent to the Court."

This is the general principle of equity as stated by this Court in the leading case of Hawes v. Oakland, 104 U. S., 450, which case resulted in the formulation and announcement of the 94th equity rule. This principle of equity was even then an old one, for the Supreme Court based its action on the earlier English case of Foss v. Harbottle, 2 Hare, 461 (decided in 1843), in which Vice Chancellor WIGRAM, after asserting that a stockholders' suit could not be maintained "without reasons of a very urgent character," further held that there must be a preliminary appeal to the board of directors and, if ineffectual, to the stockholders, as the institution of the suit was for the directors and stockholders to determine.

In the later English case of Macdougall v. Gardiner, 1 Chancery Div., 13, Lord Justice JAMES gave the same reason for the rule:

> "Because there may be a great many wrongs committed in a company—there may be claims against directors, there may be claims against officers, there may be claims against debtors, there may be a variety of things which a company may well be entitled to

> complain of, but which, as a matter of good sense, they do not think is right to make the subject of litigation; and it is the company, *as a company*, which has to determine whether it will make anything that is a wrong to the company a subject matter of litigation, or whether it will take steps to prevent the wrong from being done."

The mere existence, therefore, of a claim,—well or ill founded,—on the part of a corporation against a third party does not of itself justify the action of some of the stockholders in asserting said claim by a lawsuit. They can no more usurp corporate authority in instituting lawsuits than in any other feature of the Company's business. In entering the corporation, they submit their interests as stockholders to the judgment of the majority.

To these considerations, which are fully stated and illustrated by the English and American cases and especially by the decisions of this Court, hereinafter cited and quoted, is added in this country a consideration of even greater importance, and that is the constitutional rights of citizens as to suing and being sued. In the present case, neither the Constitution nor statutes of the United States had given the Federal Courts any jurisdiction to determine this controversy between the Susquehanna and the Delaware Companies (both being New York corporations), *and this bill was an attempt to confer jurisdiction, otherwise without warrant of law.*

It is true that this was not the result of any collusion between the Susquehanna Company and the complaining stockholders. While the collusive suits to confer jurisdiction constituted one of the evils at which Rule 94 was aimed, yet the rule had a fuller purpose and a broader application, and was obviously intended to prevent not only the usurpation of corporate authority but the unconstitutional resort to the federal courts by stockholders who on their individual initiative sought to bring the rights of a corporation into a federal court which would otherwise have been without jurisdiction.

In this aspect, Rule 94 is, in this age of corporate enterprise, of immense importance, for the management of a corporation has frequently no graver responsibility to meet than to determine under what circumstances and in what forum its rights shall be enforced, and if individual stockholders, often in the minority, can, without consulting either their associates or the governing body of the corporation, commit the corporation to litigation in a forum, otherwise without jurisdiction, the constitutional limitation of federal jurisdiction becomes ineffective. It needs no citation of authorities to establish the proposition that the contingencies are few which will justify such usurpation of corporate authority, and where individual stockholders thus virtually take from the Company's managing body the right to initiate suits in its behalf, *they must conclusively show, both by the allegations of their bill and by their proofs that they are within the few exceptions which the Courts have recognized.* They must show that they did in good faith exhaust all their remedies within the corporation, that they made every reasonable attempt to get those to act to whom the corporation had delegated the decision of such a question, and if they have failed to make an attempt within the corporate body to secure such action, *they must further show by specific and unequivocal allegations in their bill and by equally specific and unequivocal facts in their proofs, that any application by them to the governing body or to the shareholders would have been wholly futile and nugatory. If there be doubt as to this, the doubt must be resolved against the individual stockholders.* Whether such futility has been shown in the facts, as certified to this Court, will be considered in the next two points.

SECOND POINT.

The stockholder of a corporation cannot on his individual responsibility commence an action for the benefit of the corporation against another corporation, without first applying to the managing body of his corporation to do so, and the fact that a majority of such managing body are also officers, directors or employees of the corporation against which the suit is sought to be brought will not, in the absence of fraud, excuse the failure of the stockholder to make such application.

The only question which seems open to discussion is whether the mere fact that a majority of such Board were also "officers, directors or employees" of the company sought to be sued, and that some of them had only a nominal stock interest in the Susquehanna Company, *in itself and in the absence of any circumstances of fraud, so conclusively demonstrates the futility of such application as to excuse it.* This conclusion could be justified only on the assumption that there is a *conclusive* presumption of law that the directors of a corporation will not institute a suit against another corporation, with which a majority are identified either as "officers, directors or employees."

Certainly this Court has never held that any such presumption exists. It would be in direct opposition to the general presumption of fidelity, which has been often recognized and acted upon by this Court, and explicitly so in the case of the directors of a corporation in matters connected with Rule 94. Thus in Corbus v. Alaska Company, 187 U. S., 455, it was said :

> **"The directors represent all the stock-"holders and are presumed to act honestly "and according to their best judgment for "the interests of all."**

The claim sought to be asserted by this suit was *not* against the directors of the Susquehanna Company, but against a separate and entirely solvent company, and did not arise from any circumstances of a fraudulent character, but was based wholly upon a new construction of a railroad lease. The certificate does not state that the claim had ever been heard of earlier than six months before this suit was brought (p. 3). Moreover, the claim was not of a character involving any perversion of the corporate powers of the Susquehanna Company, but was merely a suit for rent, which could have been tried in a common law action and the proof of which depended wholly upon the construction to be given by the Court to written instruments, the existence of which was not disputed.

The question in this case is whether there was any insuperable obstacle to the institution of the suit by the corporation itself, simply because a majority of the Susquehanna Company's officers and directors were likewise "officers, directors or employees" of the Delaware Company. The fact, also stated by the certificate, that a number of the directors owned no shares in their own right, but were qualified by shares owned by the Delaware Company, presents no element of illegality. The New York Statute (§ 40 of Stock Corporation Law—Chapter 688 of Laws of 1892) expressly provides that the officers of one corporation which owns stock of another corporation shall be eligible to the office of director in the latter, "the same as if they were individually stockholders therein." On the presumption that directors will honestly and fairly respect the trust committed to them, it is submitted that it must be presumed that any reasonable request as to the bringing and conduct of a suit, which the complaining stockholders might have made, would have been respected. Certainly there is nothing in the Certificate to warrant the conclusion that these directors would have been wanting in their full duty as trustees for the stockholders of the Susquehanna Company.

The vice of the appellees' position is that they gratuitously assume that the directors of the Susquehanna Company, men of recognized standing and probity in the business world, would have been faithless to the trust reposed in them, and this solely for the reason that a majority were, as officers, directors or employees, also identified with the Delaware Company.

Certainly the presumption that directors will fully discharge their duties to all the stockholders should not be overborne at least until they have first refused, upon demand, to bring suit under conditions that will fully safeguard the interests of the stockholders, and until such demand and refusal the ordinary presumption of fidelity to a trust, as announced by this Court, still remains.

That this conclusion is in accord with the consistent ruling of this Court can be seen by a comparison of both those cases in which a stockholder's bill has been sustained and those in which it has been dismissed.

Hawes vs. Oakland, 104 U. S., 450, is so familiar that it requires no further quotation. It is wholly favorable to our contention.

In Detroit vs. Dean, 106 U. S., 537, this Court showed that even a formal declination by a Board of Directors, on demand, to sue, will not justify a stockholders' suit, when it is simulated or collusive. The Court said :

> "A single stockholder in a corporation has undoubtedly the same right to institute legal proceedings against the corporation for the protection of his individual rights that a third party, not a stockholder, possesses; but when he resorts to such proceedings to protect, not simply such interests, but the property and rights of the corporation against the action or threatened action

> of third parties, *thus assuming duties properly devolving upon its directors, he must show a clear breach of duty on their part in neglecting or refusing to act in the matter, amounting to such grossly culpable conduct as would lead to irremediable loss to him if he were not permitted to bring the matter before the courts. And such neglect and refusal must not be simulated, but real and persisted in, after earnest efforts to overcome it.*"

In Dimpfell v. Ohio Ry. Co., 110 U. S., 209, two complaining stockholders filed a stockholders' bill against a railroad, to declare certain bonds which the Company had issued null and void. It did not appear that they had made any attempt to prevent the issuance of the bonds or that they had made any appeal to the Directors not to take the action complained of. Mr. Justice FIELD speaking for this Court, said:

> "Grievances real and substantial must exist, and before an individual stockholder can be heard he must show in the language of this Court that 'he has exhausted all the means within his reach to obtain within the corporation itself the redress of his grievances or action in conformity to his wishes.'"

In Quincy v. Steel, 120 U. S., 241, this Court held that the prerequisite of a demand upon the Board of Directors is not met even by a perfunctory written request. The case well illustrates the degree of "particularity," demanded by Rule 94, which this Court will exact in stockholder's suits, where not only corporate authority, but federal jurisdiction is sought to be usurped by the verbal jugglery of a pleader. The Court said:

> "The rule also requires that he must set forth *with particularity* his efforts to secure action on the part of the managing directors or trustees of the corporation of which he is a member, and, if necessary, of the shareholders, and the causes of his failure to obtain such action. In the case before us he seems to have made but a single effort to induce the directors of the gas

company to institute a suit against the city to recover the money, and this was by a communication in writing addressed to the board, August 1, 1885. No copy of that letter is produced, but it is said that the board of directors laid the communication on the table. No copy of the order of the board upon the subject is produced; no effort at conversation with any of the directors, or any *earnest* effort of any kind upon his part to induce the directors to bring the suit is shown in the bill; no attempt to call the attention of the shareholders to this matter during the four years in which he said he was a shareholder, and during which time the city was failing to pay its debt to the gas company, nor any effort at any of the meetings of the shareholders or of the directors to induce them to enforce the rights of the company against the city, is shown."

In Taylor v. Holmes, 127 U. S., 489, the Court enforced this jurisdictional rule under circumstances which strongly illustrate its extreme indisposition to relax it. Two stockholders had brought a stockholders' suit against their corporation and a third party, to correct a deed made by the third party to the corporation. It appeared that the corporation itself was extinct by limitation of its charter, although it was continued under the laws of New York for the purposes of liquidation. It further appeared that many of the directors of the Company were dead. Nevertheless this Court said:

> "Although the allegation of the bill is that many of the directors of the Company are dead, *still it is shown that one of them survives, and no assertion is made that there was any application to this surviving director on the part of the defendants for the purpose of instituting any proceedings* looking to the rectification of this deed or for the recovery of the real estate in North Carolina; nor does it appear that there was any request made to him to bring any suit either at law or in chancery for that purpose. *No effort was made to call together the stockholders to take any action on the part*

of the Company or to elect other directors or to obtain any united action in the assertion of the claims now set up."

In Corbus v. Alaska Treadwell Gold Mining Company, 187 U. S., 455, the Court again ruled that even circumstances of exceptional hardship would not permit stockholders to usurp the authority of the corporation in the matter of litigation. In this case, some stockholders brought suit against a mining corporation, to enjoin it from paying certain license taxes which were claimed to be unconstitutional. The corporation was engaged in mining in Alaska, for which territory the license taxes were enacted. The directors resided in San Francisco. The plaintiff, as stockholder, therefore averred that he had "not been able, because of the great distance at which the directors of said Company reside," to request them to refuse to pay said taxes and to apply for said license, but had made such a request of the officers or agents of said Company controlling its business in Alaska, but they had failed and refused to make such application, because of the severity of the penalties. This Court said:

> "It must not be understood that a mere *technical* compliance with the foregoing rule is sufficient and precludes all inquiry as to the right of the stockholder to maintain a bill against the corporation. This court will examine the bill in its entirety and determine whether, under all the circumstances, the plaintiff has made such a showing of wrong on the part of the corporation or its officers and of injury to himself as will justify the suit. *The directors represent all the stockholders and are presumed to act honestly and according to their best judgment for the interests of all. Their judgment as to any matter lawfully confided to their discretion may not lightly be challenged by any stockholder or at his instance submitted for review to a court of equity. The directors may sometimes properly waive a*

> *legal right vested in the corporation in the belief that its best interest will be promoted by not insisting on such right. * * * The rule requires that the plaintiff must set forth with particularity the efforts made by him to secure action by the directors.* It does not appear that he made any effort to secure such action, but he relies simply on the distance of the directors from the place where he resides and in which the court is held as an excuse for not applying to them. We are of opinion that the excuse is not sufficient. *He should at least have showed some effort. If he had made an effort and obtained no satisfactory result either by reason of the distance of the directors or by their dilatoriness or unwillingness to act, a different case would have been presented,* **but to do nothing is not sufficient."**

A consideration of the few cases, in which stockholders' bills have been sustained, will show even more strikingly the rule as above stated.

In Dodge v. Woolsey, 18 How., 331 (decided before Rule 94 was added to the Equity Rules), it was shown that the stockholder had requested the Board of Directors to test the constitutionality of a suit " and that it refused to do so "

In Greenwood v. the Freight Co., 105 U. S., 13, the stockholder alleged that

> " he had requested and urged the directors of the Marginal Freight Company to take steps to assert the rights and franchises of the Company against what he believed to be unconstitutional legislation, *and that they had declined and refused to do so.*"

He further set out the formal resolution of the directors making such refusal, and this Court sustained the bill because " *the corporation peremptorily refused to move in the matter.*"

Much reliance was placed by the complainants in the Court below upon the Income Tax Cases. (Pollock v. Farmers' Loan and Trust Company, 157 U. S., 429.) It is true that the bill was maintained, but jurisdiction was assumed practically by

the consent of both parties. Mr. Assistant Attorney-General Whitney, representing the Government, agreed:

> "In view of the great public interest aroused and of the fact that no cases in proper form are now pending, these objections (to the jurisdiction of the action) are waived on behalf of the Government, so far as it is in the power of its officers to waive them."

In the later case of Corbus v. Mining Co., 187 U. S., 455, 459, the Court expressly disclaimed any intention by its opinion in the Income Tax cases to

> "determine to what extent a Court of Equity will permit a stockholder to maintain a suit nominally against the corporation but really for its benefit."

Doctor v. Harrington, 196 U. S., 579, will probably be chiefly relied upon by the appellees, *as it is the only decision in which this Court has sustained a stockholders' suit where no preliminary demand had been made either upon the directors or the stockholders.* The facts, however, in that case were wholly exceptional and bear no resemblance to the facts in the present case. The allegations of the bill disclosed a *fraudulent and criminal conspiracy* engineered by the defendant Harrington to deprive the corporation of its property by a collusive and fictitious judgment. Harrington controlled the corporation, for it was alleged that

> "the voting power on a majority thereof was given to the defendant John J. Harrington, who directed the management of the affairs of the corporation, dictated its policy and selected its directors."

For the purpose of defrauding this corporation, Harrington organized another corporation and thereupon caused the first named corporation to deliver to the second promissory notes representing no consideration and fraudulent in character, upon which Harrington permitted judgment to be taken

by the new corporation against the old. *The officers and directors of the old corporation, on the allegations of the bill, must have been participants in these frauds.*

The bill then averred:

> "The complainants are unable to secure any corporate action on the part of the defendant Sol Sayles Company to redress the wrongs hereinbefore set forth, nor are they able to obtain any redress at the hands of the stockholders of the said defendant Sol Sayles Company. The board of directors of said corporation is under the absolute control and domination of the defendant John J. Harrington, and the said Harrington, by reason of having possession of a majority of the capital stock of the said corporation, likewise controls the action of the stockholders. *Although requested for information with regard to the facts hereinbefore set forth, he has refused to give any information with regard thereto, and has declined to redress the wrongs of which complaint is herein made, or to give to the complainants any opportunity to lay before the board of directors or the stockholders of the defendant Sol Sayles Company the facts herein set forth.*"

On these allegations this Court sustained the bill.

The distinction between Doctor v. Harrington and the case at bar is obvious. The Delaware Company did not own a majority of the stock of the Susquehanna Company, but less than one-seventh of it. The Susquehanna Board of Directors never refused any request for information nor otherwise acted in fraud of the stockholders' rights, as did Harrington and the officers of the corporation. Moreover, the Susquehanna Board never "declined to redress the wrongs of which complaint is herein made," as did Harrington; nor did either it or the Delaware Company deny to the complainants "any opportunity to lay before the Board of Directors or the stockholders" the facts of the controversy, as did Harrington. Moreover, the Harrington case was based upon circumstances

of criminal fraud, while the Delaware Company case is a simple claim for a debt based upon a written contract, and involving only an honest difference of opinion as to its true construction. In the Harrington case, the stockholders exhausted every method of redress within the corporation. They appealed to Harrington to hold a directors' or stockholders' meeting, to prevent the immediate consummation of a criminal fraud upon their rights. In the case at bar, the complaining stockholders never made any demand upon the directors of the Susquehanna Company either for information or corporate action, but acted on their own initiative, wholly on the gratuitous assumption that the directors might be faithless to their trust, because some of them happened to be officers, directors or employees of the Delaware Company. There is not the pretense of any fraudulent conduct or concealment on the part of the directors of the Susquehanna Company. The "statement of facts" in the certificate does not contain a single finding of a fraudulent act on the part of anybody.

In Chicago v. Mills, 204 U. S., 321, the bill averred the formal demand that the directors institute the suit, "and a refusal of the Company to bring action." It was further shown that

> "at the annual meeting of the stockholders of the Company a resolution directing the beginning of the suit was defeated."

For this reason, the bill was sustained.

In *Ex parte* Young, 209 U. S., 123, 143, a stockholders' bill was maintained, but it appeared that the bill was preceded by a formal demand upon the directors and officers of the corporation to institute suit, and a definite refusal to do so on account of the enormous penalties provided by the Act.

In other rate regulation cases, where stockholders' suits were brought, either no point was made by the parties as to the application of Rule 94 or it was waived.

The appellees are in the last analysis driven to contend that the bare assertion in their bill, that any appeal to the directors would have been "idle and nugatory," is sufficient, although there is no finding in the "statement of facts" of the Certificate even hinting at fraud on the part of such directors. Apart from the fact that the bill can be referred to only to show the cause of action, we need only add that if the mere *averment* of futility would excuse a demand, Rule 94 would itself be futile. The pleader's license is like that of the poet, and sometimes disdains facts and substitutes conjectures and innuendoes. In formulating Rule 94 this Court did not intend that it should be nullified by the loose averments and glittering generalities of a zealous pleader. On the contrary, the rule provided that the bill must always "set forth *with particularity* the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the *causes* of his failure to obtain such action," and the Certificate herein expressly finds that

> "the bill does not set forth with particularity the efforts of the plaintiffs to secure such action as they desire on the part of the managing directors or trustees, nor does the bill set forth any efforts to secure such action on the part of the shareholders."

As previously stated, Rule 94 itself assumes, in the language of this Court, that "the directors are presumed to act honestly and according to their best judgment for the interests of all," and this presumption cannot be overborne by the mere assertion of futility or by the pleader's license in the use of adjectives or adverbs. The fraud charged and proven must be actual and not constructive. "Epithets do not make out fraud."

Kent v. Canal Co., 144 U. S., 91.
Fogg v. Blair, 139 U. S., 127.

In the last cited case, the Supreme Court held that it was necessary "to state the essential ultimate facts" and not

merely to use conclusions of law, like " fraud," " breach of trust," " colorable " and " scheme."

We close this point with a citation of a number of cases from the State Courts, in which the precise question presented in the case at bar was ruled upon on demurrer to the bill, and in each case the bill was held to be not maintainable.

In Wolf v. R R. Co., 195 Penn., 91, 95, the Court said :

> " But plaintiff relies on his averments of collusion by the directors of the lessor company to excuse the absence of demand upon them. The authorities are agreed that if it sufficiently appears that a demand would be useless, it need not be made. The averments of collusion relied upon by plaintiff are that as the lessee is the owner of a majority of the shares of the lessor, the former elects and controls the action of the officers of the latter, who have, therefore, allowed themselves to be 'kept in absolute ignorance of its business.' The defect of this charge is that it does not rest on any acts averred, but on an inference that by reason of the circumstances of their election, the directors will violate their duty and commit a breach of trust. There is, however, no presumption that officers will commit a breach of trust; the charge should rest on some act affirmative or permissive, manifestly in violation of duty, and not of erroneous judgment. The bill is radically defective, first in not averring a demand and refusal by the corporate officers to bring suit, and secondly, in not averring facts sufficient to excuse the want of such demand, and to meet the requirement that plaintiff must show every reasonable effort to get the corporation to act."

In Siegman v. Maloney, 65 N. J. Eq., 372, the New Jersey Court of Errors and Appeals unanimously held, that the failure of the complaining stockholder to make any preliminary demand upon the directors of his corporation was *not* excused by the alleged facts, that of the twelve directors five were participants in the acts complained of, that another was a

" brother of and connected in business with one of the individual defendants," and that still another was " an employee and representative of one of the other individual defendants." Chief Justice GUMMERE said:

> " But, in our judgment, these facts justify no such conclusion. On the contrary, the presumption is that, notwithstanding the relations existing between the two directors and two of the individual defendants, against whom relief is sought, the former would faithfully discharge the duty which they owed to the corporation and its stockholders, although their action would necessarily have an injurious effect upon the interests of those defendants. *Neither the existence of blood nor of business relationship justifies a presumption of dishonesty under the conditions referred to.*"

In Brewer v. Boston Theatre, 104 Mass., 378, an allegation " that the present board of directors of said defendant corporation are united in the interest of and under the control of said Tompkins and Thayer (the other defendants)," was held insufficient to excuse an omission to make demand upon the directors. The Court said:

> " It does not show that such an application upon a suitable representation of the facts, would prove unavailing."

In Dunphy v. Traveller Ass'n., 146 Mass., 495, the same Court held that an allegation, that one of the directors, who was a party defendant, " controlled a majority of the stock and has elected such persons directors as he chose," did not excuse the failure to make a preliminary demand upon the board. The Court said:

> " It cannot be presumed in the absence of such averments (of fraud or of misconduct) that they would refuse to do their duty if their attention was called to it."

In O'Connor v. Virginia, 184 N. Y., 46, 53, the New York Court of Appeals said:

> "Nor is the allegation that the new directors were 'subservient to the domination and dictation of said Frank Jay Gould and Helen Miller Gould,' sufficient to prove that they would not prosecute against the Goulds a well founded cause of action."

THIRD POINT.

If the complainants were excused under the facts certified from making any preliminary demand upon the directors, they nevertheless must show, in order to maintain their suit, that they could not have secured corporate action by an appeal to the stockholders of the Susquehanna Company.

This point is also based upon the fundamental proposition stated in the language of this Court in our first point, that a stockholder cannot maintain such a suit without first showing

> **"to the satisfaction of the Court that he has exhausted all the means within his reach to obtain within the corporation itself redress of his grievances or action in conformity to his wishes."**
>
> Hawes v. Oakland, 104 U. S., 450.

Applying this fundamental rule, of which Rule 94 is but an expression, it has been uniformly ruled by this Court that except in very exceptional circumstances the complaining stockholder must not only make a demand upon the board of

directors, but if that be denied, he must appeal to the stockholders, in whom the ultimate power is lodged. The rule is as old as the principle of equity which governs stockholders' suits and was stated in the earliest English cases. Thus, in the leading case of Foss v. Harbottle, 2 Hare, 461, upon which the Supreme Court based its leading case of Hawes v. Oakland, 104 U. S., 450, the Vice Chancellor said that

> " it was the duty of the plaintiffs—the two shareholders who complained of what has been done—*to have called a meeting of the shareholders or attended at some regular annual meeting* and obtain the action of a majority on the matters in issue."

This conclusion was based by the Vice Chancellor upon the following practical reason :

> " The majority may have been content with what was done and may have ratified the action of the Board, in which case the whole body would have been bound by it."

Following this doctrine, the Supreme Court in Hawes v. Oakland *(Supra)*, dismissed the bill, because, *inter alia*, the complainants made

> " *no attempt to consult other stockholders to ascertain their opinion or obtain their action.*"

This doctrine has been repeatedly reaffirmed by this Court.

Thus in Huntingdon v. Palmer, 104 U. S., 482, the bill was dismissed, although there had been a demand upon the directors, upon the express ground that :

> " *There is no averment of any effort to invoke the control of the body of the stockholders, or any reason why it was not done.*"

Again, in Quincy v. Steel, 120 U. S., 241, the Court sustained the dismissal of the bill because, *inter alia*, the complainant made

> "*no attempt to call the attention of the shareholders* to this matter during the four years in which he said he was a shareholder * * * *nor any effort at any of the meetings of the shareholders or of the directors to induce them to enforce the rights of the Company against the City.*"

In Chicago v. Mills, 204 U. S., 321, where the bill was sustained, the stockholders of the Company at the annual meeting had expressly refused to instruct the directors to institute the suit.

In Doctor v. Harrington, 196 U. S., 579, where the bill was sustained, the man who committed the alleged fraud had possession of and voting power over the *majority* of the stock and refused on demand to call a stockholders' meeting.

In Dickinson v. Consolidated Traction Co., 114 Fed. Rep., 232, the rule in this respect was well stated by Circuit Judge GRAY in words that are almost literally applicable to the case at bar :

> "But the rule further requires that, if necessary, application should be made to the shareholders for the same purpose. This was not done, and nothing in the evidence, or in the allegations of the bill, appears to excuse the want of such an application. *The allegation that the directors controlled a majority of the capital stock of the Consolidated Traction Company, appears from the evidence to be untrue.* The shareholders, as a body, are not accused of fraudulent or improper conduct in regard to this lease, and though the great majority voted for its confirmation, *it does not lie in the mouths of these complainants, in considering the requirements of this rule, to say what might or might not have been the result of an application made to a regular and lawful meeting of the body of shareholders.*"

Appellees may, however, argue that "the shareholders cannot control a litigation," and it may be conceded that the conduct of litigation primarily belongs to the current business of the managing body. This however is equally true of all the cases above cited, and yet the Court has regarded an appeal to the stockholders as a prerequisite to a stockholders suit. The law under which the Susquehanna Company was incorporated contained the usual clause, which left the management of the corporation to the board of directors. This is true of all corporations and is not inconsistent with direct action by stockholders as to the institution of a suit. Certainly the stockholders had at least two remedies, either of which would have been effective.

1. Assuming that the directors had declined on demand to institute the suit, a resolution adopted by a majority of the shareholders directing them to do so could not have been ignored by the directors without a breach of trust, which would have made them individually answerable in damages.

2. At the time the suit was instituted, the annual meeting was only four months distant in time and at that meeting the shareholders could, *as in fact they subsequently did*, elect directors who were in entire sympathy with the claim against the Delaware Company. As the complaining stockholders, had slept upon their rights for many years, they could reasonably have waited a few more months before taking the law into their own hands by the *dernier resort* of a stockholders' bill.

Presumably an appeal to such stockholders would not have been futile, for when did a majority of stockholders ever seriously object to obtaining larger dividends, and the inevitable result of this suit, if sustained, would have meant larger dividends to the Susquehanna stockholders. The claim was too recent in its invention to have ever been discussed or acted upon at any previous meeting of the shareholders. Apart from the undisputed developments of the subsequent election, which substi-

tute fact for presumption, and show that the complaining stockholders controlled the majority, the condition at the time of the institution of the bill was that the complainants and their associates had almost as many shares of stock as the Delaware Company and its associates, and as they were appealing to the self interest of the remaining stockholders, an appeal to them could not be regarded as presumptively futile. The Certificate states that when the suit was instituted the complainants and their associates (who had formed a protective committee) had 8,000 of the 35,000 shares of stock, while the Delaware Company and its associates had only 8,840 shares. Both factions were in a minority of about equal voting strength, and the remaining stockholders, who held a majority of the capital stock, had taken no part in the controversy. The Certificate expressly states that as a result of the contest the complainants succeeded in obtaining a majority of the stockholders' vote, electing their own board of directors, which promptly admitted the allegations of the bill and co-operated with the stockholders against the Delaware Company. It is therefore incontrovertible that had the complaining stockholders only waited from June until October, this stockholders' suit would have been unnecessary, for if it had not been previously brought by the former management of the Susquehanna Company, it would have been brought in October by the management expressly elected to prosecute this suit. There would, however, have been one difference. The Susquehanna Company would necessarily have proceeded in the Courts of the State of New York and could not have invoked the judicial authority of the Federal Court .

The complainants will argue that their success at the annual election was only made possible by the action of the Susquehanna Company in demurring to their bill The Certificate does not so state, but if it did, that would not establish their

right to institute suit without first making an *attempt* to secure action both by the directors and the stockholders.

We cannot believe that this Court will encourage an unwarranted assumption of Federal jurisdiction in a case where the facts clearly show that such jurisdiction was based upon a mere fiction that the complainants were helpless to secure redress within their corporation.

FOURTH POINT.

For the reasons hereinbefore given, we respectfully submit that this Court should give an affirmative answer to each of the two questions certified by the Circuit Court of Appeals. No hardship, which the complainants have not brought upon themselves by their unwarrantable and premature action, will befall them, for they still control the Susquehanna Company and that Company can therefore proceed in the Courts of the State of New York, the only constitutional forum for this controversy between two New York corporations, and obtain a judicial determination as to the alleged liability of the Delaware Company.

February 23, 1909.

Respectfully submitted,

JAMES M. BECK,

ALFRED OPDYKE,

Counsel for The Delaware and Hudson Company.

APPENDIX.

Certification of Question to Supreme Court.

United States Circuit Court of Appeals, Second Circuit.

Before Lacombe, Ward and Noyes, Circuit Judges.

AETNA INSURANCE COMPANY and Twelve Others, Complainants-Appellees,

vs.

THE ALBANY & SUSQUEHANNA RAILROAD COMPANY, Defendant-Appellee, and THE DELAWARE AND HUDSON COMPANY, Defendant-Appellant.

This cause comes here upon appeal from a final decree of the Circuit Court, Southern District of New York, which directs that the defendant Delaware and Hudson Company (hereinafter called the Delaware Co.) pay to the defendant the Albany and Susquehanna Railroad Company (hereinafter called the Susquehanna Co.) the amount of $1,107,923.24.

The case was fully argued and submitted on briefs. It thereupon developed that there was a question presented whether the bill could be maintained under the 94th Equity Rule. That question is a preliminary one; it has been held to be jurisdictional in character (City of Chicago vs. Mills, 204 U. S., 321; Doctor vs. Harrington, 196 U. S., 579), and this court desires the instruction of the Supreme Court for its proper decision.

Statement of Facts.

The facts upon which the question arises are as follows:

The defendant corporations are both citizens of the State of New York; the complainants are citizens of the States of Connecticut and Rhode Island. The bill was brought to obtain an accounting for various sums of money, which it was alleged became due at intervals

during a series of years from the Delaware Company to the Susquehanna Company as rental or in the nature of rental under a lease made in 1870. For the convenience of all a copy of the pleadings is hereto annexed marked Exhibit "A" which may be referred to for a more detailed statement of the cause of action. The bill does not "set forth with particularity the efforts of the plaintiffs to secure such action as they desire on the part of the managing directors or trustees." Nor did the proofs show any such efforts. Nor does the bill set forth any efforts to secure "such action on the part of the shareholders." Nor did the proofs show any such efforts. Nor did the bill set forth, or the proofs show, "the causes of their failure to obtain such action" otherwise than is hereinafter disclosed.

The complaint was filed on June 12, 1906. The Susquehanna Company was organized under the Act of April 2, 1850, which provides that "there shall be a board of thirteen directors * * * to manage its affairs," and for many years before this suit was brought a majority of the Board of Directors of the Susquehanna Company consisted of persons who were officers, directors or employees of the Delaware Company. At the time this suit was instituted, the directors and officers of the Susquehanna Company, the dates of their election as such, and their relations to the Delaware Company with dates of election were as shown on the following statement:

Names of directors of Susquehanna Company and dates of election as directors and officers.	Position in Delaware and Hudson Company and dates.
Robert M. Olyphant, 1878	Director since 1872 President from 1884 to 1903 Chairman of the Board since 1903
Ge[illegible] I. Wilber, 1883	Director since 1901
David Willcox, 1894 (Vice President, May 9, 1906)	General Counsel 1894 to 1903 Director since 1899 President since 1903
R. Suydam Grant, 1901	Director since 1886
Charles A. Peabody, 1902	Director since 1902

William S. Opdyke, 1903	General Counsel since 1903 Director since 1905
Abel I. Culver, 1903	A Vice President since 1903
Charles A. Walker, 1892	Treasurer 1892
Robert Olyphant, 1887 (President since 1889)	Son of Robert M. Olyphant
William L. M. Phelps, 1873 (Secretary since 1870)	Secretary of the Albany and Susquehanna Company, elected by the Board of Directors
Robert C. Pruyn, 1890	Nominees of the Delaware Company as stated in the Delaware Company's answer.
James H. Manning, 1890	

Of these Robert M. Olyphant, R. Suydam Grant, Charles A. Peabody, William S. Opdyke, Abel I. Culver and Robert C. Pruyn at the time this suit was begun did not own or hold in their own right any shares of stock in the Susquehanna Company, but shares of stock of that company owned by the Delaware Company were transferred to each of them on the books of the Susquehanna Company by the Delaware Company for the purpose of qualifying them as such directors. Charles A. Walker owned five shares of Susquehanna stock from 1901 to 1906; it does not appear that he owned any stock in the Susquehanna Company during the year 1906.

So far as appears from anything shown in this record none of the directors or officers of the Delaware Company ever, before or after the bringing of this suit, treated the claim therein set forth otherwise than as one of doubtful validity the payment of which was to be resisted.

On June 12, 1906, and for thirty years prior thereto, the capital stock of the Susquehanna Company had been fixed at and limited to 35,000 shares. Of this capital stock on June 12th, 1906, the Delaware Company owned 4,500 shares and its directors or officers owned or controlled 4,340 shares; the complainants owned 1,312 shares and a so-called Protective Committee who from and after December, 1905, had been opposing the administration of the Delaware Company upon the ques-

tions involved in this bill controlled 6,688 shares. The entire 35,000 shares were held by 546 different persons, of whom 423 owned 50 shares or less, and of whom 383 resided in the State of New York.

An annual meeting of the Susquehanna Co. was held subsequent to the beginning of this suit, on October 16, 1906. At that meeting the nominees of the Protective Committee were elected, receiving 15,501 ballots, the nominees of the former management receiving 15,441 ballots. About two weeks before such annual meeting the Susquehanna Company being then controlled by the directorate above named, filed a demurrer to the bill which is hereto annexed as "Exhibit B". Copies of such demurrer were sent by stockholders opposed to the existing control to all stockholders and thereafter and before the meeting proxies for several thousand shares were received by the persons who voted for the nominees then elected.

QUESTIONS CERTIFIED.

Upon the facts above set forth the questions of law concerning which this court desires the instruction of the Supreme Court are:

FIRST. "Does the fact that before institution of this suit complainants made no demand for relief upon the Board of Directors of the Susquehanna Company prevent them from maintaining this bill?"

SECOND. "Does the fact that before institution of this suit complainants made no effort to obtain relief at a stockholders' meeting prevent them from maintaining this bill?"

In accordance with the provisions of Sec. 6 of the Act of March 31, 1891, the foregoing questions of law are, by the Circuit Court of Appeals for the Second Circuit, hereby certified to the Supreme Court.

E. HENRY LACOMBE,
H. G. WARD,
WALTER C. NOYES,
Circuit Judges.

[To this Certificate the pleadings are added as an appendix. See Record, pp. 4–83.]